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BOOK REVIEWS

The Rate of Interest, Its Nature, Determination, and Relation to Economic Phenomena. By IRVING FISHER, PH.D. New York: The Macmillan Co., 1907. Pp. xix+442.

It will be remembered that Boehm-Bawerk defines interest as the premium commanded by present over future goods, and that he attributes this premium to three concurrent causes: (1) the perspective underestimate of the future; (2) a possible relative scarcity of present goods as compared with future goods; (3) the technological productivity of wealth with passing time.

Professor Fisher, in his lately issued second volume—following what is seemingly Professor Fetter's view—adopts as his thesis that only the first two of the three influences set up by Boehm-Bawerk, are properly to be invoked in explanation of the interest phenomenon:

It is the third circumstance—the so-called technical superiority of present over future goods—which we believe to contain essential error (p. 55). . . . To abstract both the underestimate of the future and underprovision for the present is to abstract the *whole* basis of interest (p. 65). . . . If we eliminate the “other two circumstances” . . . we eliminate entirely the superiority of present over future goods, and the supposed third circumstance of “technical superiority” therefore turns out to be non-existent (p. 70). . . . If we cast out from the agio theory Boehm-Bawerk's special feature, his alleged “technical superiority of present goods,” the theory which remains is believed to be correct (p. 74).

Professor Fisher is not, however, disposed to deny to productivity some bearing on the interest rate; but he insists that its influence is exerted solely through modifying the general situation within which postponement of consumption takes place; it brings about, that is, a new abstinence problem, and does this solely through modifying the relative supplies of present goods as over against future goods:

It is also true, as Boehm-Bawerk has pointed out, that not only does a lower rate of interest tend to the choice of remoter returns, but that, contrariwise, the choice of remoter returns tends to check the fall in the rate

of interest; the reason . . . being that the choice of an income-stream relatively large in the future and small in the present tends to increase the relative valuation of present as compared with future income (p. 164).

If any cause tends to lower the rate of interest, the immediate effect will be to put a premium on those income-streams the return from which is in the remote future. . . . But the decision to choose such income-streams tends to prevent the very fall in the rate of interest which caused the choice. For by relatively oversupplying the future with income, and undersupplying the present, such uses as forestry will tend to raise the relative valuation of present over future income, and therefore also to raise the rate of interest (p. 175).

Nature offers man, as one of her optional income-streams, the possibility of great future abundance at trifling present sacrifice. This option acts as a bribe to man to sacrifice present income for future, and this tends to make present income scarce and future income abundant, and hence also to create in his mind a preference for a unit of present over a unit of future income (p. 186).

The effect in raising interest comes merely from the shifting forward of the income-stream, which leaves the immediate income smaller than before, but compensates for this by a still greater increase afterwards. . . . The rate of interest, for contracts connecting the periods of scarce income with those of plentiful income, tends to be high (p. 199).

The deferred increase is expected to yield a return on the immediate sacrifice at a rate sometimes far greater than the rate of interest. But this high rate of return on sacrifice to the exploiter of the newly discovered method of utilizing capital does not by itself fix the rate of interest at that level. On the contrary, the valuation of the property is immediately adjusted to the new conditions (p. 199).

Thus we are to understand Fisher to assert that the use of any productive process or the use of any sort of productive wealth can exert an effect upon the rate of interest only through modifying the individual's estimate of the relative importance to him of present goods as against future goods. How shall the owner of an instrument of production, say, a farm, employ it—for farming? for forestry? for mining?

In the case of optional income-streams, the particular choice depends upon the rate of interest (p. 145). . . . The intensiveness of his farming is thus determined by the rate of interest (p. 157). . . . The choice will fall on the option whose marginal rate of return on sacrifice, reckoned relatively to the neighboring option, is equal to the rate of interest (p. 158). . . . Those investments which most promptly yield returns are formed first, and the less rapidly returning instruments are successively formed, until the margin

is reached which corresponds to the rate of interest. . . . A certain decrease of present income will be accompanied by a certain increase in future income. The relation between the immediate decrease and the future increase will vary within a wide range, wherein the choice will fall at the point corresponding to the ruling rate of interest (p. 159). . . . The intensity with which he will improve and cultivate his land is determined by the current rate of interest (p. 161).

That this correctly sets forth the attitude and the computation of the individual operator is past question; but is there not at the same time some influence exerted to modify the rate of interest—and, if so, how? Does each productive instrument merely receive its value from an interest rate elsewhere and otherwise determined? Or do productive instruments themselves, as an aggregate, through the very fact of the productive opportunities which they offer, have an effect in determining that interest rate under which each is separately capitalized? And do new processes, inventions, and appliances somehow bear to affect the rate?

All preference for present over future goods resolves itself, in the last analysis, into a preference for early enjoyable income over late enjoyable income (p. 90). . . . When any other goods than enjoyable income are considered, their values already imply a rate of interest. When we say that interest is the premium on the value of a present house over that of a future house, we are apt to forget that the value of each house is itself based on a rate of interest. . . . Both terms of the comparison involve the rate of interest. . . . But when present *ultimate* income is compared with future *ultimate* income, the case is different, for the value of ultimate income involves no interest whatever (p. 91).

The rate of interest expresses a price in the exchange between present and future goods. . . . Time-preference is the central fact in the theory of interest (p. 88).

True, "not only does a lower rate of interest tend to the choice of remoter returns, but, contrariwise, the choice of remoter returns tends to check the fall in the rate of interest"—but the reason is stated as "being that the choice of an income-stream relatively large in the future and small in the present tends to increase the relative valuation of present as compared with future income" (p. 164).

Here, then, is the issue: Fisher does not dispute the doctrine of Boehm-Bawerk that newly opened lands, newly invented appliances, newly devised methods, have a bearing to raise the rate of interest,

but only that the productivity fact is a separate and independent cause of interest; he ascribes the influence of productivity solely to its effect upon the relative importance attached to present over future goods. Larger opportunities for profitable investment are presented as having ultimate bearing upon the rate, not by using up the supplies of capital or by increasing the volume of the demand for capital, but solely by limiting the present supplies of consumption goods at the same time with increasing the supplies of future goods,—and thereby increasing the premium of present goods over future goods:

The lower the rate of interest, the better can the owner afford to keep his carriage in repair, and the higher the state of efficiency in which it and all other instruments will be kept. . . . The very attempt . . . tends in turn to increase the rate of interest; for every repair means a reduction in present income for the sake of future—a shifting forward in time of the income-stream—and this will cause a rise in the rate of interest (p. 195).

The effect in raising interest comes merely from the shifting forward of the income-stream which leaves the immediate income smaller than before, but compensates for this by a greater income afterwards. . . . The high rate of return on sacrifice to the exploiter of the newly discovered method of utilizing capital does not by itself fix the rate of interest at that level. On the contrary, the valuation of the property is immediately adjusted to the new conditions (p. 199).

Since the invention will more than repay this cost . . . the effect will be to decrease immediate and increase remote income for society as a whole. Borrowing and lending merely distribute the pressure upon those most willing to bear it; but the effect is . . . to cause a temporary depression followed by an ascent in the income-stream, and therefore to increase somewhat the rate of time-preference and the rate of interest (p. 200).

Society . . . directs its labor to great engineering enterprises . . . which cannot begin to contribute a return in enjoyable income for many years. In contemplation, future income, during this period, is relatively plentiful and, in consequence of these great expectations, the rate of interest will be high (p. 203).

There is, then, it will be noted, no denial made by Fisher that the productivity of wealth has an effect upon interest rates—that it is a cause—but only a denial that it is a separate and independent cause. The issue is, then, only as to the sense in which it is a cause, and as to the method of its action: if one shifts a weight from one side of the scales to the other, the tipping of the scales may certainly be said to be caused by the shifting of the weight, but it may also

be rightly asserted that this is only through the disturbance of the relation between the two weights. And by reasoning precisely parallel it has been said that a new supply of any commodity has no effect upon price, simply because—once the supply is present—the adjustment becomes purely a matter of the nature and volume of the demand.

If this, then, is really the issue, one might stop to ask himself, what of it—supposing it all to be true; is the issue really worth while?

But is it all, indeed, true? Could not the reproductive power of wealth establish an interest-rate even "if we eliminate the other two circumstances"? After all, is "the supposed third circumstance nonexistent"? Is it true that "the imagined third circumstance . . . is only the first two circumstances in disguise"?

Surely, (1) the perspective underestimate of the future may suffice to place a premium on present goods; and surely also (2) the relative scarcity of present goods as compared with future goods would also equally well suffice to bring about this premium: but how about the reproductive power of capitalistic process as an independent cause?

Let it be assumed, as an extreme test case, that present needs and desires are so far weak or so far satiated as to approach the limit of nonexistence or of disappearance—a situation in which, by the very terms of the assumption, there can be neither any "prospective underestimate" of the future, nor any degree of inadequacy in "present provision"—there being in fact no desire for present consumables, but only a clear appreciation of the certainty of tomorrow's need. If now it be clear that, for each unit of the existing wealth of today, there may by tomorrow be derived two units for tomorrow's consumption, is it not certain that there will forthwith set in a vigorous competitive bidding for control of the present facts offering command of tomorrow's consumable goods, and that there must result an interest rate approximating to 100 per cent. per day?

It is extremely difficult to decide how far and in what sense Fisher concurs in Boehm-Bawerk's assumption that comparison is possible in competitive society between *goods* in the present and *goods* in the future. Most of Fisher's analysis proceeds upon the implied assumption of this possibility: "Could it always be assumed that the monetary standard was invariable in value with reference

to all goods, the rate of interest reckoned in money would be the same as though it were reckoned in terms of the goods themselves" (p. 78). But even were it to be accepted that the comparison is possible, Professor Clark long ago made it clear that, in the market transactions of a competitive society, the comparison does not actually take place. And it is equally clear also that neither borrowing nor paying commonly takes place in terms of any concrete goods—whether farms or machines or raw materials or consumables. The borrowing runs in terms of present purchasing power according to the established money standard, and the future settlement is agreed to be worked out in like terms. The contract and all the operations under it sound purely in terms of price, precisely as the gain in contemplation by the entrepreneur is computed as nothing else than a balance in terms of price. And no other computation is of the slightest significance to him—unless, possibly, as somehow derivative from the price-gain which he is engaged in seeking. The interest problem is, then, not one of surplus value, or of surplus consumption goods, or of surplus future income, but only of surplus price. Only so far as surplus goods bring surplus price can surplus product of any sort stand as relevant to the computation.

For the purposes of the interest problem, therefore, anything is productive which, in the actual situation of the entrepreneur, makes for a price-increment for him. The computation has to do solely with productivity as interpreted from the individual-acquisitive point of view. The borrowing is of a fund of purchasing power. This purchasing power may, truly, be directed into machinery, farms or raw materials—into lines, that is to say, of technological and social productivity—but so, equally well, may it not. Instead, it may go into buying the right to levy taxes, or to enjoy a monopoly, or otherwise to plunder society; or the borrowed fund may be invested in bribing the city council to grant a desirable franchise, or into advertising expenditure, as a process of indoctrinating the public with profit-rendering Hop-Bitter or Peruna misinformation. In any case, if the adventure promise a return in price-increment, it will contribute to the demand for loanable funds, and, as based upon it, there may emerge an interest rate.

And out of the general theory of distribution something may be deduced for the purposes of interest theory: Even where the borrowed funds are used by the entrepreneur in the purchase or hire of instruments of production, his problem remains precisely the same

problem of how to get out of the future price-result a price-balance over the price outlay. Enough of purchasing power must be advanced for labor to divert it from ministry to other demands—whether the consumption demand or the demand of some competitor—enough for machines to get them produced for the purpose, and enough for land to command its service; and in connection with this investment there goes the entrepreneur's own activity of supervision and co-operation. When the time arrives for computing the gains upon the adventure, there is no way of attributing a certain quantum or proportion of the price result to the labor hired or to the funds advanced for the labor—or any certain other amount to the machinery hired, or any third amount to the land employed; nor is it possible even to attribute any certain sum of acquisitive-productivity to the aggregate of the borrowed funds. All that the entrepreneur can know is that by employing the borrowed funds or their proceeds in connection with his own activity—and very possibly also in connection with funds or instruments of his own—this new borrowing could be made so to signify to him in terms of price-increment as to justify the promise to pay a price-interest increment. The rate of time discount, therefore, is a rate fixed and determined in the loan-fund market: all properties—instrumental or other—that command a hire receive a value through the application of this interest rate to the computation of the present worth of these hires.

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A Living Wage: Its Ethical and Economic Aspects. By JOHN A. RYAN, S. T. L.; with an Introduction by RICHARD T. ELY, PH.D., LL.D. New York: The Macmillan Company, 1906. 8vo, pp. xvi+346.

This work, according to Professor Ely, is an attempt "to elaborate what may be called a Roman Catholic system of political economy." The specific thesis of the book is that "wages should be sufficiently high to enable the laborer to live in a manner consistent with the dignity of a human being." "To defend this general conviction by setting forth the basis of industrial, religious, and moral fact upon which it rests, is the aim" of the volume.

Essentially, this treatise is not economic but ethical in its nature. The mere facts that the subject is wages and that industrial data